April 2, 2004

Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-1181—Notice of Proposed Rulemaking Regarding Community Reinvestment Act Regulations

Dear Ms. Johnson:

Members of the National Association of Affordable Housing Lenders (NAAHL) appreciate the opportunity to comment on the proposed changes to the Community Reinvestment Act (CRA) rules.

NAAHL represents America's leaders in moving private capital to those in need. Our nearly 200 member organizations include 71 insured depository institutions, 50 non-profit providers, GSEs, insurance companies, pension funds, foundations and others committed to increasing private capital lending and investing in low- and moderate-income communities.

We are very concerned that the proposals contained in the joint interagency Notice of Proposed Rulemaking (NPR) regarding the Community Reinvestment Act could turn back the clock on efforts to meet the credit needs of our communities. This will summarize our major concerns.

THE NPR FAILS TO ADDRESS LEGITIMATE PROBLEMS

Nine years have elapsed and a century has turned since the current rules were written. And what we have learned is that these regulations pressure institutions to do what is right for the call report, and actually discourage them from tackling the toughest credit needs of their communities. We learned that the existing regulations discount the importance of doing the really hard stuff, like the multi-layered, subsidized, affordable rental housing deals and the redevelopment of distressed neighborhoods. We learned that the regulations force institutions to twist straightforward loans in low- and moderate-income neighborhoods into "investments" to meet an arbitrary benchmark test set by examiners. We learned that, in some communities, there are very limited opportunities for sustainable business investments, and finding the eligible “needle in the haystack investment” forces lenders to use resources unproductively.

The tremendous importance of what we learned over the past decade confirms the regulators’ wisdom in calling for a thorough review of the regulations in 2002. Nonetheless, after this extensive review process and the proposed Notice’s thoughtful discussion of the many issues NAAHL and others raised about the economic distortions associated with the current lending and investment test regulations, the Notice for the most part fails to address the problems.

We do not agree with the stated view of the Notice that the problem is solely one of “implementation”. Rather, we believe that the rules are the problem, effectively discouraging institutions and their community partners from using limited resources to meet the greatest needs. And given that the agencies have spent the past 2 to 3 years reviewing concerns with the current regulations before agreeing to this very limited proposal, the prospect for “future guidance” that helps restore some balance seems very dim indeed.

THE NPR PROVIDES THE WRONG SOLUTION TO THE PRACTICAL PROBLEMS WITH THE REGULATION

Rather than put forward the optional “Community Development Test” NAAHL proposed to address the real-world shortcomings in the 1995 regulations, or make any constructive effort to support the complicated, multi-layered, multi-subsidy housing and community and economic development projects most needed in low- and moderate-income communities, the Notice merely responds to one subset of the investment test problem – “comments that smaller institutions at times have difficulty competing for investments” – by simply relieving more than 1,200 institutions from investing, as well as from detailed reporting on loans and services.

At the FDIC meeting on the Notice, agency staff reported that this change was being made without any analysis of the impacts of such a change on affected communities.

We urge that the agencies make some effort to strengthen the community and qualitative focus of the current regulations for all institutions, in the spirit of the mandated review of how the regulations have worked over nearly a decade. Just doubling the threshold for compliance, without understanding all of the ramifications of that decision, is the wrong solution.

THE NPR APPEARS A RETREAT FROM EXISTING, STRONGER STANDARDS AGAINST PREDATORY LENDING

Despite strong language in the Preamble about the regulators' intention to examine "all credible evidence" that an institution might be involved in abusive lending practices, that broader standard is very unclear throughout the rest of the proposals. Some even interpret the proposals as providing a new "safe harbor" for abusive practices other than asset based lending. If the agencies' intent was to clarify the kind of "credible evidence" that could impair an institution's overall CRA rating, the Notice should be revised to make that clear.

We urge you to reconsider the significance of what you proposed to do, as well as the importance of what you did not do. As always, we are happy to meet with you to discuss our concerns, and look forward to working with you to address legitimate, practical problems with the CRA regulations, to further our mutual goal of meeting communities' credit needs.

Sincerely,

Judith A. Kennedy
President

October 19, 2001

Ms. Jennifer Johnson
Secretary, Board of Governors of
The Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-1112 – Advance Notice of Proposed Rulemaking Regarding the Community Reinvestment Act Regulation

Dear Ms. Johnson:

The National Association of Affordable Housing Lenders (NAAHL) represents more than 200 organizations, including more than 85 insured depository institutions, and 800 individual community investment practitioners who are committed to increasing the flow of private capital into low- and moderate-income communities. As you know from our ongoing dialogue with all of the bank regulators, our experience suggests the importance of several mid-course corrections to the rule, both to ensure the sustainability of this business, and encourage meaningful community investment in this new millennium. Our thoughts on the specific issues are as follows.

Large Retail Institutions: Lending, Investment, and Service Tests
Do the regulations strike the appropriate balance between quantitative and qualitative measures, and among lending, investments, and services? If so, why? If not, how should the regulations be revised?

It is important to restore some balance between consideration of quantitative and qualitative factors to ensure both that CRA business is not over-subsidized in a non-sustainable way, and to permit the institution to do what is right for the community rather than for the call report.

The Problem
While the 1995 regulation made great progress in bringing credibility to CRA performance, some aspects of it have gone too far in the quantitative direction. The emphasis on statistical information -- to provide the public with information about the extent to which insured depository institutions make loans and investments -- can be so great as to obscure the community needs, performance context, and business case for some loans and investments. This

overemphasis also obscures the fact that all communities do not have the same needs, just as all institutions do not have the same expertise. This inevitably results in some unintended distortions. For example, a community may not have much demand for investments or even certain types of loans, such as mortgages for multifamily housing. Nonetheless, examiners are reluctant to acknowledge the performance context in which institutions operate, requiring that institutions make their "numbers". This can result, at best, in non-productive resources being spent finding the needle in the haystack, or at worst, in perverse economic consequences when too many lenders are chasing the same deal. It focuses institutions on competing where markets are well served, when it would be more valuable for the community for institutions to address unmet needs.

In addition, many practitioners' experience with the investment test leads them to question whether it should continue as a standalone test, as well as the weight given to it. Most NAAHL members believe that mid-course corrections are particularly important for the long-run effectiveness of CRA. Various proposals for reform seem to reflect differences both in assessment area needs and an institution's market niche, as well as the proliferation of some hyper-competitive market areas, along with the extent to which an institution's examiners appreciate the performance context.

It is clear that the quantitative emphasis, combined with low or no demand for viable investments in some communities, results in pricing distortions and unsustainable business in some markets. In addition, where there is high demand for loans but little or no need for investments in an assessment area, the pressure to find "investments" causes non-productive bank resources to be spent twisting a straightforward business opportunity like a loan into a qualifying "investment". Finally, many investments, such as in small tax credit deals, are largely illiquid, yet regulators are reluctant to continue to give CRA credit for the period in which the bank's capital is tied up in these deals.

It is understandable that examiners find it difficult to evaluate activities that are not easily measurable. Initiatives that are truly innovative or complex are very resource-intensive, and because they often address the most acute needs in a community, generate low numbers. Nonetheless, careful, qualitative assessment of these initiatives, such as lending on tribal lands or stimulating new commerce in Appalachia, is critical to encouraging institutions to address the greatest needs.

Recommendations
To address the imbalance between quantitative and qualitative factors in assessing CRA performance, we have several suggestions. First, both non-profit organizations and insured depository institutions suggest that all of the qualitative aspects of CRA performance be reorganized into a single, separate community development test. This new test would incorporate all community development lending, community development investments, and community development services.

Such a regrouping should not only provide a better balance, but also afford more flexibility to institutions to design CRA programs that match community needs with their business strategies. It should be simpler to analyze an institution's community development activity as a whole. Most important, it should make it easier for an institution to make the greatest effort where the greatest need exists, without a requirement to meet artificial ratios, twist loans into "investments", or make "investments" that are written off as grants.

The purpose of the combined test would be to follow the format of the wholesale/limited purpose Community Development Test, whereby an institution can choose to focus on one or more of the three components. This type of flexibility will allow an institution to target its resources to areas of need based on their local communities and synergies with the institution's areas of expertise and operational infrastructure.

Second, greater emphasis must be given to the Performance Context in evaluating banks' performance. All communities do not have the same needs, and all institutions do not have the same business strategies. Examiners must consider unique community needs as well as how well markets are being served and legitimate barriers to real needs.

Third, our members also are concerned about consistent application of the rules across all regulators and all geographic areas. Inconsistent interpretation and application of the rules has been a continuing problem and should be addressed by regulators in the context of the CRA rewrite.

Does the Lending Test effectively assess an institution's record of helping meet the credit needs of the entire community?

Yes -- to an extent. However, as we described above, the undue emphasis on quantitative measures compels lenders to focus on products and services that produce the right "numbers", rather than consider – and respond to – the greatest needs of the community. The pressure to satisfy quantitative measures leads to uneconomic business in more and more markets, thereby jeopardizing the sustainability of the business. Too often, examiners tend to equate activities that are "innovative" or "flexible" with "unprofitable". Based on the considerable experience practitioners now have with the 1995 rule, we believe that the rule needs to provide institutions with greater flexibility both to respond to each community's unique needs and to align their CRA activities with their business expertise, rather than just play the "numbers" game.

We also believe purchased loans should be given equal weighting to loan originations because loan purchases are equally important in providing liquidity, which helps to lower the cost of mortgage lending.

Does the Investment Test effectively assess an institution's record of helping to meet the credit needs of an entire community?

Investments can be critical to meeting the credit needs of some low- and moderate-income (LMI) individuals and communities. Nonetheless, the overarching measure of a lender's performance in meeting the credit needs of the local community should be how well the institution addresses that community's unique needs, and not an artificial requirement to achieve certain volumes.

Unfortunately, the Investment Test has had many unintended results, some of which we described above. While this test undoubtedly was intended to increase a lender's flexibility in addressing community needs, it has increasingly become something of a millstone. Different communities require a different mix of loans, services and investments to meet their unique credit needs. This separate test and the quantitative emphasis to performance undermine the institution's ability to choose whether investments will help it to meet the credit needs of a particular community.

In some communities, there are very limited opportunities for sustainable business investments. Many so-called investments are, in fact, grants with no expectation of a yield or principal repayment. And, in some affluent communities, there are actually no legitimate investments that benefit low- and moderate-income persons. As a result, "junk" investments have been created and marketed, which provide "numbers" for institutions, often carry high risk and very low yield but do not, in fact, address the real credit needs of the community.

In addition, the current regulations result in little or no credit for investments that occurred prior to the review period that are still on a bank's books. Institutions that are attempting to meet important credit needs with long-term, largely illiquid or below-market-rate investments in local affordable housing or other eligible activity should receive continued credit for such investments.

Does the Service Test effectively assess an institution's record of helping to meet the credit needs of its entire community?

The test has been effective, but now needs to be updated to be more flexible. The rapid growth of alternative delivery methods, such as the internet, telephone and mail, allow delivery of services in new and important ways. If an institution makes effective and extensive use of these alternatives to meet the credit needs of its community, they should be weighed heavily in the exam. Banks should be given credit for *all* they are doing to serve a community beyond just specific branches – for example, establishing a presence in a community facility, maintaining a mortgage lending office, or providing ATMs.

Similarly, the "finance related" tie in the current regulations is too restrictive. Bank employees volunteering with community-based organizations should not be restricted to finance, investment or other finance-related functions for an institution to receive CRA benefit. Institutions should receive CRA credit for all volunteer activities related to community building and development, such as helping to build a home in Habitat for Humanity projects, which contribute to building sustainable communities.

Are the definitions of Community Development appropriate?

Today, community development is a dynamic and innovative business, but the current rules discourage an innovative response to a community's credit needs. The definitions should be expanded to allow more flexibility in responding to a community's needs. The application of the "primary purpose" concept is too restrictive. We recommend that, going forward, consideration of community development include, but not be limited to, activities such as the following:

- loans to LMI individuals or communities;
- loans or investments in projects that provide housing, jobs or other benefits to LMI individuals or communities;
- provision of financial services to LMI individuals or communities;
- grants to organizations that engage in community development activities;
- equity investments in organizations or projects for the purpose of community development;
- related activities, such as letters of credit or other credit enhancements supporting community development projects or applications to the Federal Home Loan Bank for supporting community development projects.

Activities that enable community development also should count as qualified investments. For example, all of an investment in a mixed-income development where the market rate units *enable* affordable units should count (not just the portion which is affordable) because the investment meets the community's need for credit to integrate LMI households.

In addition, we support the need for a simplified method of determining whether a multifamily project is "affordable housing for LMI individuals", thereby meeting the definition of "community development". One method we support was recommended in Fannie Mae's 1999 comment letter to the FFIEC (see the attached copy).

Small Institutions
Do the provisions relating to asset size and holding company affiliation provide a reasonable and sufficient standard?

These provisions would provide a reasonable and sufficient standard if they followed the asset size of the bank, as opposed to the current practice of following the holding company's asset size.

Limited Purpose and Wholesale Institutions: The Community Development Test
Are the definitions of "wholesale" and "limited purpose" institutions appropriate? If so, why? If not, how should the regulations be revised?

The definition of limited-purpose bank should be expanded to include retail banks that have no branches or that have branches that are incidental to the primary business strategy of the bank. We support expanding the availability of the Community Development Test, allowing a large retail institution to choose the option that best addresses the community's needs and the institution's strengths.

Performance Context
Are the provisions of the performance context effective in appropriately shaping the quantitative and qualitative evaluation of an institution's record of helping to meet the credit needs of its entire community?

The Performance Context should be an important element of the CRA evaluation but, in many instances, it has been extremely difficult to persuade examiners to acknowledge the specific, external environment in which each bank operates. Even in extremely high-cost areas, like New York City, or credit surplus areas, like Wilmington, examiners often seem unable or unwilling to acknowledge the operating environment.

We recommend that the regulators reinforce the critical importance of this necessary, intellectual framework with which to evaluate institutions.

Examiners should receive needed training and resources to enhance their expertise in this work. To the extent possible, regulators should pool resources and data to provide all examiners across all agencies with readily accessible information. The examiners should share with their regulated institutions their assessment of the external environment, and the institution should have the opportunity to review and comment in a productive dialogue with its examiners.

Assessment Areas

Do the provisions on assessment areas, which are tied to geographies surrounding physical deposit-gathering facilities, provide a reasonable and sufficient standard for designating the communities within which the activities will be evaluated during the examination?

If a bank is adequately meeting the credit needs of its assessment area, then all qualified lending, investing and services outside its assessment area should be given favorable consideration. This important flexibility should help communities with unmet needs, and reduce economic distortions in hyper-competitive markets.

Data Collection

Are the data collection and reporting and public file requirements effective and efficient approaches for assessing an institution's CRA performance while minimizing burden?

Collecting the required data, making sure that it is accurate, and maintaining the public file is an increasingly burdensome and expensive undertaking. As more and more institutions operate in many states, and with the recent addition of disclosures mandated by the Sunshine regulations, a tremendous amount of labor and paper goes into this work. The cost/benefit relationship of these requirements should be re-evaluated. It is also important to note that every change in data collection requirements necessitates substantial systems changes and costs at every institution, and further reduces the ability to track trends in lending over time. We suggest that it should be an accepted principle that such changes should only result from a major need in furtherance of CRA.

In this new millennium of technological communications and multi-state financial institutions, the current rules requiring multiple public files now kill way too many trees for little or no benefit. Very few people go into branches and ask for CRA file information. Each institution should provide one paper set of data only, and each branch office should be required to have written contact information to respond to inquiries that tells people the various ways to access all of the institution's information.

Finally, race and ethnic data should not be included in the CRA exam. Fair lending is about fair treatment of protected groups, including racial and ethnic minorities, many of whom are not of low- or moderate-incomes.

We appreciate all of the effort the agencies have made to eliminate unintended barriers to meeting the credit needs of low- and moderate-income persons and communities. We hope that you will take this opportunity to make corrections to the 1995 rule to further increase the flow of private capital and strengthen institutions' ability to meet these credit needs in the new millennium, and we look forward to working with you on these goals.

Sincerely,

Judith A. Kennedy
President

April 5, 2002

John D. Hawke, Jr.
Comptroller of the Currency
Office of the Comptroller of the Currency
Independence Square
250 E Street, SW
Washington, DC 20219-0001

Dear Jerry,

This responds to your challenge to NAAHL to develop a proposal for updating the CRA regulation. By way of background, the 3 principles underlying NAAHL's approach to CRA and Community Development and informing this proposal are:

Sustainability: No loan or investment should be made which is not viable in its own right – meaning that it can achieve its developmental purpose over time without continued sustaining financial intervention. However, a comprehensive community development (CD) strategy will include grants and other types of financial assistance to low- and moderate-income (LMI) individuals and organizations.

Flexibility: The key to what is allowable and creditworthy under CRA should be "what works", i.e., what loans, investments, and services contribute to improvement in the lives of LMI individuals.

Responsiveness to community/market needs: Banks should be able to create, change, and modify their CRA oriented programs to reflect changed conditions in their markets and communities. Examiners should recognize such changes in community and market conditions and reward CRA programs that work.

<u>The Community Development Oriented Plan:</u>

As an option (not dissimilar to the choice available with the "Strategic Plan"), a bank could choose as an alternative to the standard Lending, Investment, and Service Tests, to be assessed under two new tests which differentiate between the community reinvestment responsibility to provide financial services to the institution's assessment community on the one hand, and the narrower but pressing need to assist LMI individuals and/or revitalize the communities within which they live or work. These alternative tests would be:

- Retail Banking Test – consisting of mortgage loans, small business loans, consumer loans (optional), and retail banking services. This would be similar in scope to the existing small bank test.

- Community Development Test – consisting of community development lending, community development investments, and community development services.

The Retail Banking Test will measure the institution's success in meeting the credit and financial service needs of its assessment area. These activities (whether lending or services) will be included in the Retail Banking Test as a component of the institution's assessment area activity and to ascertain the institution's distribution of these activities within the assessment community.

The Community Development Test -- Definition and Purpose:

Community Development encompasses those activities of a financial nature or otherwise, which have the effect of improving the life condition of LMI individuals, or of stabilizing and revitalizing the communities in which they live or work. In order to receive community development credit for CRA purposes, a project need not have community development as its "primary purpose", so long as a significant consequence of the project or activity benefits LMI individuals or communities. For example, all of a mixed-income development transaction where the market-rate units *enable* affordable units should count (not just the affordable portion) because the transaction meets the community's need for LMI housing. Another example is a city-sponsored project in a community, which is not LMI, where the institution finances or supports downtown revitalization or rehabbing of an older shopping center where LMI individuals are likely to find employment. In addition, it should not be required that an activity be explicitly "financial" if it works to the benefit of LMI individuals or communities.

The Community Development Test will include, but not be limited to, activities such as the following:

Funding of CDFIs and other community development intermediaries;
Funding community development venture capital funds;
Loans/investments/grants in projects or to organizations which provide housing affordable to LMI individuals, or to LMI communities;
Loans/investments/grants in projects or to organizations which provide jobs, supportive services, or other relevant benefits to LMI individuals or LMI communities;
Facilitating the creation of affordable housing through the use of low income tax credits;
Purchase of mortgage-backed-securities backed by loans to LMI individuals;

Participation in government sponsored programs, such as the SBA, with evaluation based on the LMI definition that the specific government entity uses;
Grants to organizations engaged in community development activities;
Providing financial education and banking services tailored to the needs of the unbanked;
Equity investments in organizations, small businesses, or other projects for the purpose of community development;
The initiative shown by the institution in developing unique/special LMI targeted lending programs; and
Related activities such as:

- Providing standby letters of credit or other credit enhancements supporting community development projects (<u>to be included and itemized in the CRA Loan Disclosure);</u>
- Applications to the Federal Home Loan Bank for support of community development projects, the contingent liability taken on with such projects, and employee time spent in administering and monitoring these activities;
- Employee time devoted to a large variety of community development activities, such as construction of homes through the auspices of organizations such as Habitat for Humanity;
- Bank officers and other employees participating in community development organizations, even if they include non-financial activities.

When examining an institution's community development program, the Examiner would look to the totality of the bank's community development activity, recognizing that the balance among community development lending, investments, services and other related activities may vary substantially from bank to bank and community to community so long as the total impact of the bank's community development outreach is consistent with its performance context and institutional expertise, and meets a reasonable standard related to community needs.

<u>Weighting:</u>

If an institution were to choose this alternative plan for satisfying its community reinvestment responsibility the weighting for each test would be agreed upon prior to the examination, with the weighting for the Community Development Test to be no lower than 25% and no higher than 50% of the total. In keeping with the overriding consideration of flexibility in the direction each institution takes in meeting its community development responsibilities and the flexibility Examiners have to evaluate the totality of an institution's program without rigid adherence to hard and fast allocations, we believe that weighting should be determined within the context of the individual institution's business strategy and the needs of its community. As an example, an institution which does not offer a particular product line would be evaluated with weightings based on the products it does offer.

HDMA, Small Business, and (Optional) Consumer Loans:

HMDA and Small Business loans will continue to be reported as they currently are, and considered in the retail banking test. Standby letters of credit or other credit enhancements supporting community development projects will be reported and included under the Community Development Test, as noted above. There will be no double counting of loans, investments, or services. For examination purposes, all activities will be categorized as falling under the Retail Banking Test or the Community Development Test.

Determination of Which Test to be Examined under:

At the time when the Regulator notifies a bank of an upcoming CRA Examination, but no more than 12 months prior to an exam, the bank will inform the Regulator of its wish to be examined under the standard Lending, Investment, and Service tests, or its preference to be examined under the Retail Banking and Community Development tests. This flexibility allows that even though a bank might normally be expected to opt for and develop its CRA plans for one or the other of the alternate examination processes, changing bank circumstances and community/market conditions may prompt the bank to change its program in such a way as to make the alternative testing standard appropriate.

Thank you for the opportunity to suggest this approach. We would look forward to continuing our dialogue on these important matters.

Sincerely,

Judy Kennedy
President